

RICHARD RUSSELL'S DOW THEORY LETTERS, INC.

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LETTER 833

Apr. 8, DJIA 842.94; PTI 1359; A-D Ratio -24.79
Apr. 16, DJIA 843.42; PTI 1373; A-D Ratio -24.48

THE MARKETS: Sometimes a writer uses facts, sometimes he uses statistics, and sometimes he uses his intuition. I'm going to use my intuition now. Up to the present, this bear market has been relatively simple to read. As subscribers know, the bear has left easy-to-follow tracks ever since April, 1981—when the Dow topped out at 1024.05. The bear signal of July 2 was certain to be valid—since few analysts noticed it, and those who did, ignored it.

The market sank to a low in late-September, following which a rally took the Dow back to 892.69 in December. The new year (1982) saw the bear take over again, and the direction of the market was relentlessly down. On March 8 the Averages recorded new lows, Industrials at 795.47, Transports at 314.36.

From the over-sold lows of March 8, 1982, the Averages turned up. By mid-April Industrials had reached the 840 area, Transports, the 350 area. But the market was huffing and puffing—it was over-bought.

So far, this market has acted as expected. The 233-day cycle (see Letter 831) turned up in mid-March, and the market dutifully rallied as if it had read the script. I view the whole picture since mid-March as "let-up time" for Wall Street. Following a terrific first quarter battering, ALL the markets have climbed off the floor—from stocks to commodities, from heating oil to gold to money instruments. As I've written so many times before, all movements (whether minor, secondary or primary) are entitled to a one-third to two-thirds correction. And the markets have been correcting since early-March.

Now I want to discuss two widely held (almost consensus)

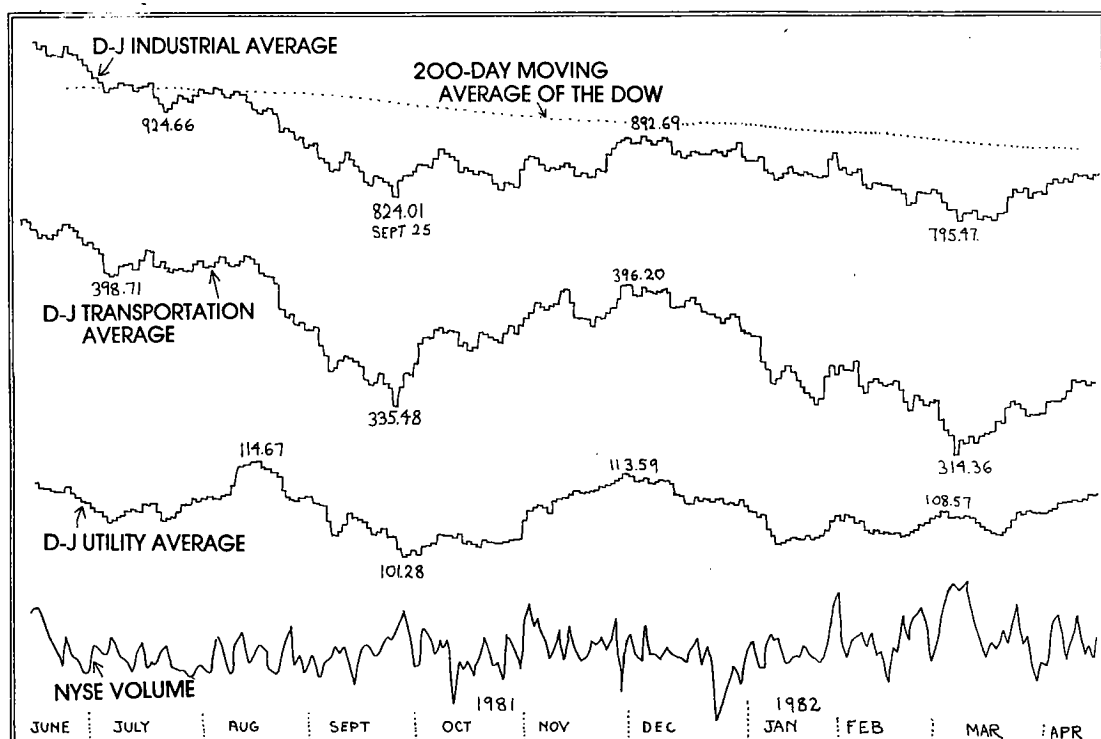
FRONT PAGE COMMENT: I don't think most investors fully understand what's happening on the Federal Budget front. To put it briefly, the situation is grim. For the current (1982) year, the usually accurate OMB estimate for the deficit is \$125 billion. On top of that that, "off budget" expenses will add \$25 billion to the total. That adds up to a total deficit of \$150 billion. But I think that figure is going to be low. Tom Holt (Holt Investment Advisory) thinks we will see tax revenue drop \$25 billion under estimates while he thinks transfer payments will be \$15 billion higher.

Economist Dr. Henry Kaufman believes the Treasury will have to raise around \$90 billion in second half of 1982. My guess is that the final figure will be higher. But any way you look at it, pressure is going to increase on the bond market as this year drags on.

Meanwhile, the President and the politicians are "working" on a budget compromise. I don't expect much from the compromise. The problem is that expenses are increasing faster than the compromisers can cut (if indeed they do cut). I feel that we are moving towards a crisis in the debt picture. Only a crisis can force the politicians to face the fiasco they have created. Only a crisis will force the politicians to take realistic action.

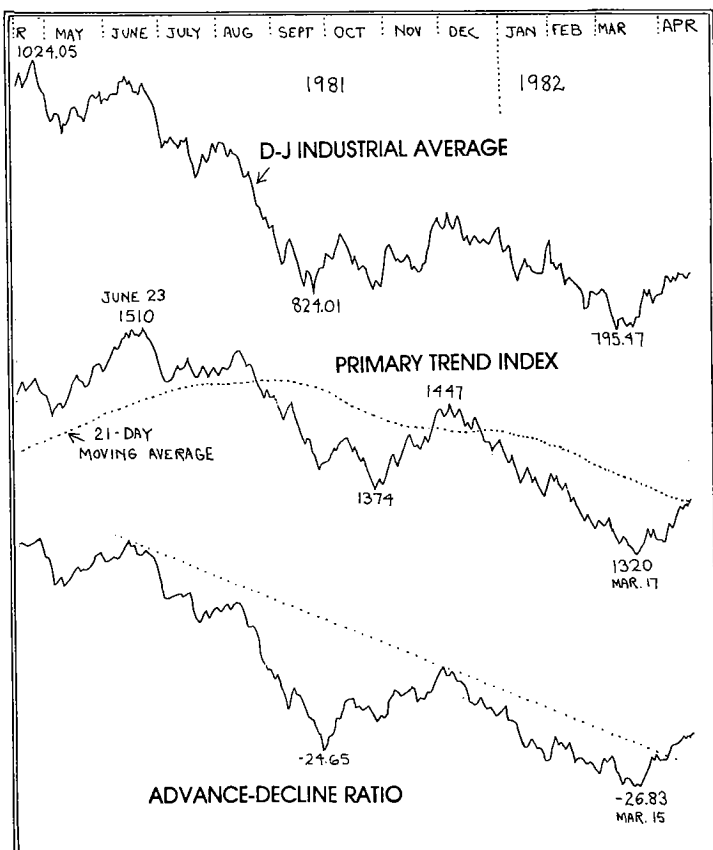
opinions: (1) The economy will rise in the second half of the year. (2) With inflation down sharply, interest rates "have to come down."

Frankly, I am skeptical on both counts. I'm not at all convinced that the economy has to rise, and I'm not at all convinced that interest rates have to fall. The wish can be father to the conviction.



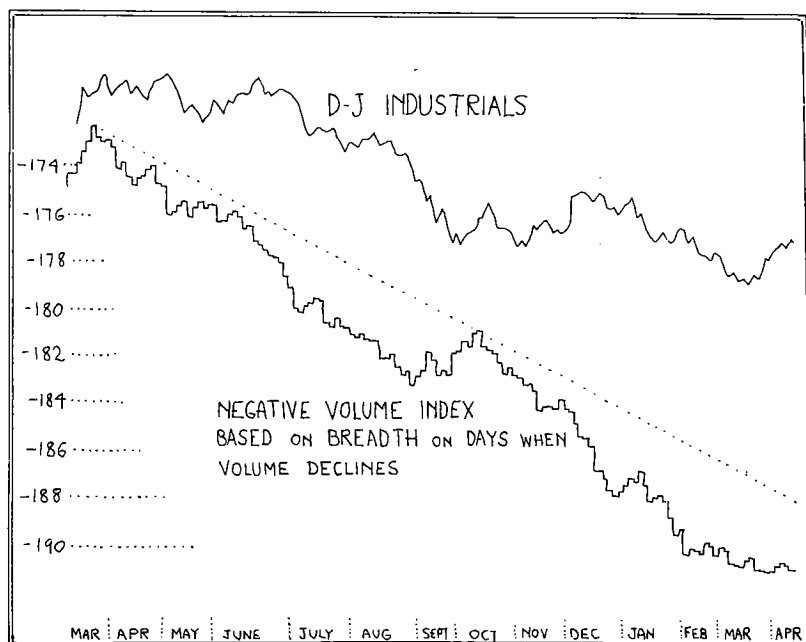
So I'm back to my intuition. Intuition tells me that the stock market is going to be tricky, frustrating, confusing—for a while, perhaps for a few months. The bear market has been easy to follow up to now, but I think the picture may now turn murky. And remember this, the bear's fondest desire is to take as many stockholders as he can with him—when he makes his next trip to lower levels. To do this the bear must offer hope, he must foster greed, he must allow the market to appear enticing.

Meanwhile, the rally has been lackluster. At mid-April the market was actually over-bought; it was wheezing. The odd-lotters



have been swinging to sharply higher selling, a move which usually is accompanied by market strength. But strength has strangely been lacking. Market breadth has been sluggish, and, in fact, since the March 7 lows we have seen only three days in which there were as many as 1000 advances (there should be **MANY** such days during a truly powerful advance). Furthermore, the negative volume index has been holding at the low, a poor sign.

Now let's turn to the chart of the Primary Trend Index (PTI). Here we see that the PTI has removed an over-sold condition by rallying back to touch its declining 21-day moving average. But drawing a trendline connecting the June and December peaks,



you can see that the PTI is still far from reversing its downward trend. So far, the PTI is saying, "normal rally in a bear market."

The A-D ratio has reversed a declining trendline that started at the June high. But the A-D rally has been sluggish. With the minor trend of the market up for almost six weeks, the rise in the majority of stocks (as measured by both the A-D ratio and daily new highs) has been labored and unimpressive.

NEGATIVE VOLUME: (see chart at lower left) Most people are very interested in what the market does when volume is rising. But they are singularly disinterested in what happens when volume is falling. I guess the natural reaction to rising volume is, "This is exciting, something important must be going on." Conversely, when volume diminishes people think, "What a drag, nobody's buying or selling, so why should I care what's happening when the market is dull."

Ironically, these reactions tend to be incorrect. Paul Dysart, founder of Trendways (Dysart has been dead many years) based his historic volume studies on various divisions of the advance-decline figures. Dysart used the standard A-D ratio, and he added positive volume and negative volume. Dysart noted that the public tends to become interested and buy on days when volume is increasing. He also noted that the informed money prefers to trade on days when volume is down and dull.

So Dysart developed positive and negative volume indices. The positive volume index includes the pluralities of advances over declines (or declines over advances) on any day when volume is **ABOVE** the preceding day's volume. The negative volume consists of the plurality of advances over declines (or declines over advances) on days when volume is **BELOW** the preceding day's volume.

I've followed the positive and negative volume indices for 15 years, and I agree with Dysart that the more important index is the negative volume index. The trail of negative volume shows the direction (buying and selling activity) of informed money.

Lately, there has been a rather dramatic divergence in the positive and negative volume indices. Whereas the positive (uninformed money) volume index has been pushing towards the highs, the negative volume index has been recording new lows. I consider this divergence bearish. It is telling me that under the guise of excited uninformed mass buying, the informed minority has been selling. If past history is a guide, the informed (but more powerful) minority is going to win. Thus, before the summer is over I would expect positive volume to come down hard; I don't think the positive volume index (or the A-D ratio) can hold up under the steady barrage of selling in negative volume (see chart).

Another observation: I can't remember seeing an impressive market advance without some kind of upside participation by the negative volume index. But negative volume is down and dull. Therefore, unless we see a real change in the character and direction of the negative volume index, I have to think that this market will be heading down. The situation will be rendered that much weaker by the steady buying (rising positive volume) of the uninformed segment (i.e., the uninformed segment could be the pension funds). In a struggle between positive and negative volume (as now), negative volume ultimately wins.

MONEY: Albert Einstein once wrote, "There are two things that are infinite, space and human stupidity." Maybe we should add a third, US debt. At any rate, in my

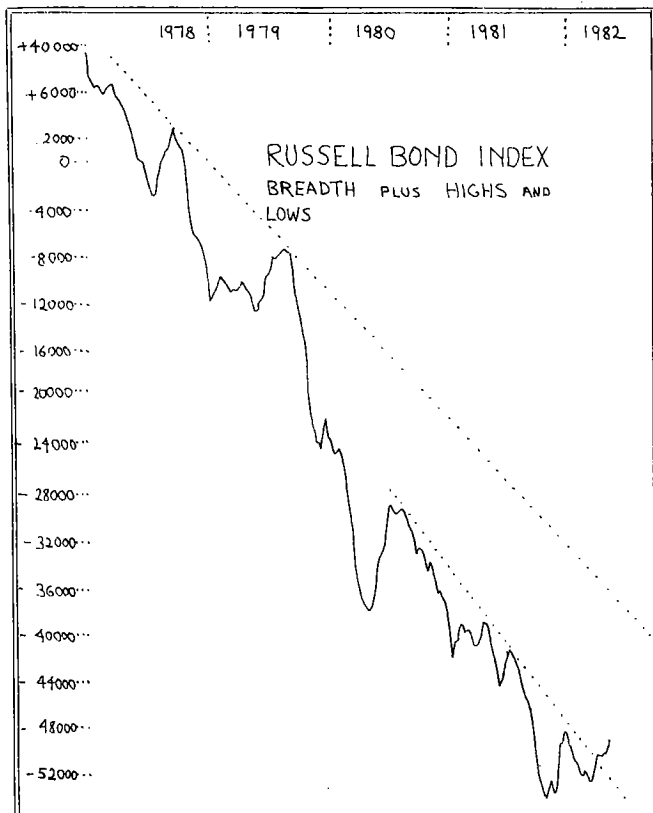
thinking the total US debt has become the DOG that is wagging the market's tail. A lot of analysts are running around adding up M-1, M-2, interest rates, GNP, new orders for this and that. But as you know, I watch the US debt, and I track it like a hawk. And it only does one thing—it gets BIGGER.

The bigger the debt gets, the more money it takes to sustain it. The total debt owed by everybody (individuals, corporations, states, Federal) is now \$5.4 trillion. The total Federal debt alone is \$1.06 trillion.

Every newspaper and magazine seems to carry a quote from some expert to the effect that by summer (or fall or winter) interest rates "should" be down. Furthermore, they don't understand why rates haven't collapsed already. And the answer is that these experts don't understand debt. They don't understand that you either inflate away the \$5.4 trillion in debts (thereby destroying the currency) or that \$5.4 trillion crushes you; it eats up all the money in sight just to sustain itself. Consider this: at current 12-13% rates it takes \$670 billion a year or \$56 billion a month just to CARRY the total US debt.

All of this is reflected in the money markets, and more specifically in the bond market. I use a very broad-based index of my own to follow the bond market. I call it the Russell Index. It's the daily advances plus new highs minus daily declines plus new lows from the New York Exchange Bonds (about 950 different bonds are traded each day).

As you can see, the Russell Index has done nothing very exciting since its recent bottom. When, if and as a big bond move on the upside arrives, we'll see it in the Russell Index. It hasn't happened yet.



Speaking of money, one of Wall Street's leading money experts, Dr Henry Kaufman, was interviewed in the April 12 US News and World Report. It was an outstanding interview and I include a few excerpts here:

Q What are your recommendations?

A We should cut the tax reduction of 10 percent scheduled for this July 1 to 5 percent. We should also rescind the tax cut scheduled for 1983 as well as the indexing of the tax structure that is to take place in 1985.

To go along with that, I would do away with all indexing of government programs, including Social Security. We ought to create a budgetary process where we are all at stake in the inflationary process. If the taxpayer or the recipient of government checks gets hurt by inflation, then he will be against inflation. If we index either taxes or benefits, then we are accepting inflation rather than fighting it.

I would also consider imposing a gasoline tax, probably at the pump. There is a national reason to conserve energy, and a tax would reinforce that. It could raise 10 or 15 billion dollars a year.

Q Where will we be if Congress does nothing before the November elections?

A The crucial time frame is the next three months. Until then, it will not be clear as to how the economy will move. But assume we get into early July with interest rates falling, signs of an economic recovery and the tax cut taking effect. People will say, "These policies are working. So leave them alone." There will be no sentiment in those two or three months before the election to do the negative things that need to be done—cutting expenditures, raising revenues, removing tax incentives.

So the time horizon is very short. Either action will be taken before July, or you can forget about it and take the risk of what follows.

Q What if Congress takes action after the elections?

A If Congress waits, it means, realistically, that action will take place early in 1983 at the soonest, about a year from now. The problem is that we can't simply freeze the economic situation over that period. In the second half of this year, for instance, the U.S. Treasury will have to borrow close to 90 billion dollars to finance the deficit.

Q If there is no acceptable compromise on the budget deficit, what are the odds that the recession would develop into something much worse?

A There would be subnormal recovery. There is at least an even chance that 1983 will produce very little or no real growth. That means that we continue to be in this framework of sputter and spurt that we've operated in since 1979. The longer we continue this, the more underlying risks there are and the more you weaken the economy.

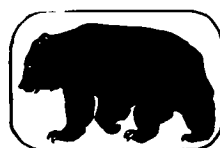
Q How worried are you that the country will slide into a depression like that of the 1930s?

A I hope that was only a once-in-a-lifetime experience. As analysts, we really have no experience in knowing if and when it will come. Nevertheless, risks are greater today than they were.

American industry is not functioning very well. We've had serious productivity problems for some time. The financial system is more leveraged. Credit quality is deteriorating, and corporate profits are not rebounding. If you look beyond the shores of the U.S., the rest of the world is struggling with its economies. The entire world-debt structure is bigger and more cumbersome. In that sense, the dangers are considerable.

The situation is certainly more risky. Twenty years ago, I would have said the odds were 1,000 to 1 against another depression; 10 years ago, 100 to 1 against it; today, the odds are maybe 8 or 10 to 1. That is still substantially against it, but the odds are coming down.

INVESTMENT POSITION: One of the nice things about markets is that you don't have to be in them ALL the time. This is a great comfort to anyone who possesses humility and some kind of balance. After all, you don't exhale all the time, you don't talk all the time, you don't stay awake all the time. So why do you have to be in the stock market all the time.



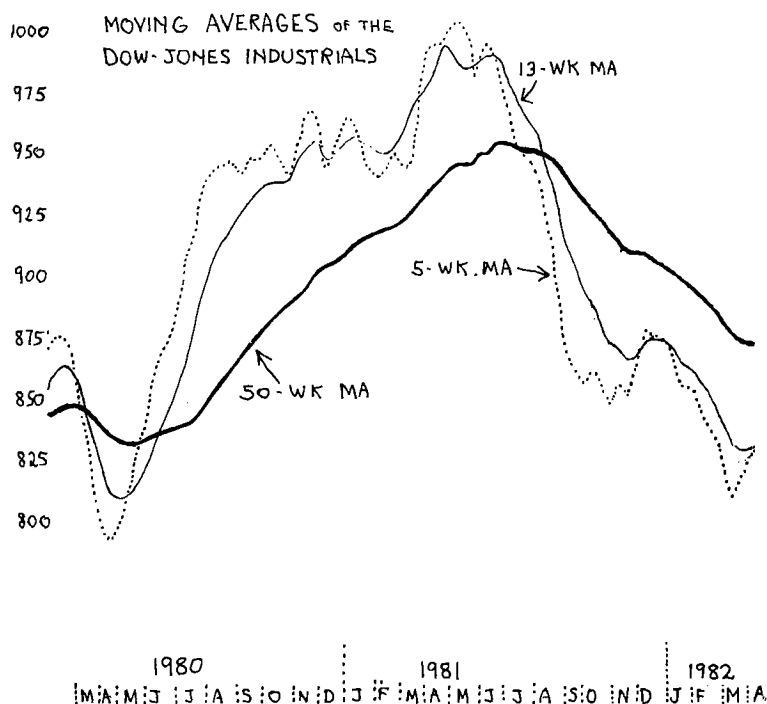
As explained under the market section, I expect a period of deception, confusion, trickiness coming up. So I'll leave this market to the geniuses who insist on playing every move. I'm telling my subscribers to stay with our position of 10% long-term Treasury bonds, 15% 3-5 year notes and the rest in T-bills. If you

feel venturesome, move to 20% T-bonds and 20% 3-5 year notes. And please, don't write me to ask exactly which bond to buy. Your broker should have the brains to help you here. If he doesn't, then by all means get a broker who knows the money markets. A broker who isn't thoroughly familiar with the money market here in 1982 is like a ship's captain who can't read a compass—he's useless.

MORE ON MOVING AVERAGES: In the last Letter I included a study on the 200-day moving average of the Dow. A more sophisticated version of the moving average study is the relationship of the three moving averages of the Dow. For this study I use a short or 5-week MA, an intermediate or 13-week MA and a longer term or 50-week MA. I might add that in tabulating my moving averages, I do not use the standard method, but rather the "exponential" method based on the relationship of the latest figure and the preceding figure. This method results in a much more sensitive change in the moving averages, but unfortunately, I don't have the space here to go into the exact working of this method.

The crux of the 3-moving averages method is the relationship between the 13-week and the 50-week MA's. I also give a good deal of weight to the direction (up or down) of the MA's. Thus, when the 50-week MA is rising and the 13-week MA pushes above the 50-week MA, this constitutes a bull signal. Conversely, when the 50-week MA is declining, and the 13-week MA breaks below it, such action constitutes a sell signal.

"But what of the 5-week MA?" you ask. I use the 5-week MA mostly as an early harbinger of potential change in direction. Obviously, the earliest "alert" signal comes when the 5-week MA (1) turns up or down, and (2) when the 5-week MA crosses above or below the 13-week MA. But the big signals, the important signals, occur when the 13-week MA rises above an ascending 50-week MA, or when the 13-week MA breaks under a declining 50-week MA.



What is the value of the moving average study? To me, the great value is that the MA study is totally mechanical, it cannot be manipulated, fiddled with, changed. When a buy or sell signal arrives, that's it—the study is saying something, and you either believe it or ignore it. But it's always dangerous to be on the wrong side of the major buy and sell signals of the moving averages. For this reason, I always like to know exactly where the Dow is in terms of the MA's.

Currently, as you can see on this chart, the 5-week MA is correcting and has pushed just above the 13-week MA. But the 13-week MA is still far below the declining 50-week MA. The relationship of the 13 and 50-week MA's is therefore still bearish. And that is the main message of the three MA study at this time.

GROWTH LINES: I've discussed the value of semi-logarithmic (often termed ratio) scale in charting. Ratio scale deals in percentages of advance or decline. Thus, a rise from 75 to 150 (a 100% rise) will appear as the exact vertical distance on a ratio chart as a rise from 300 to 600 (also a 100% rise) or a rise from 2 to 4 (a 100% rise).

When trendlines connecting major lows are drawn on ratio charts, these trendlines can be likened to rates of advance. In other words, as long as a given value holds above a rising trendline on a ratio chart, it can be said that the rate of growth remains in force.

Long-term rates of growth always interest me. It also interests me greatly when long-term rates of growth are reversed. As a rule, the longer the growth trendline, the greater the significance when that rate of growth turns down.

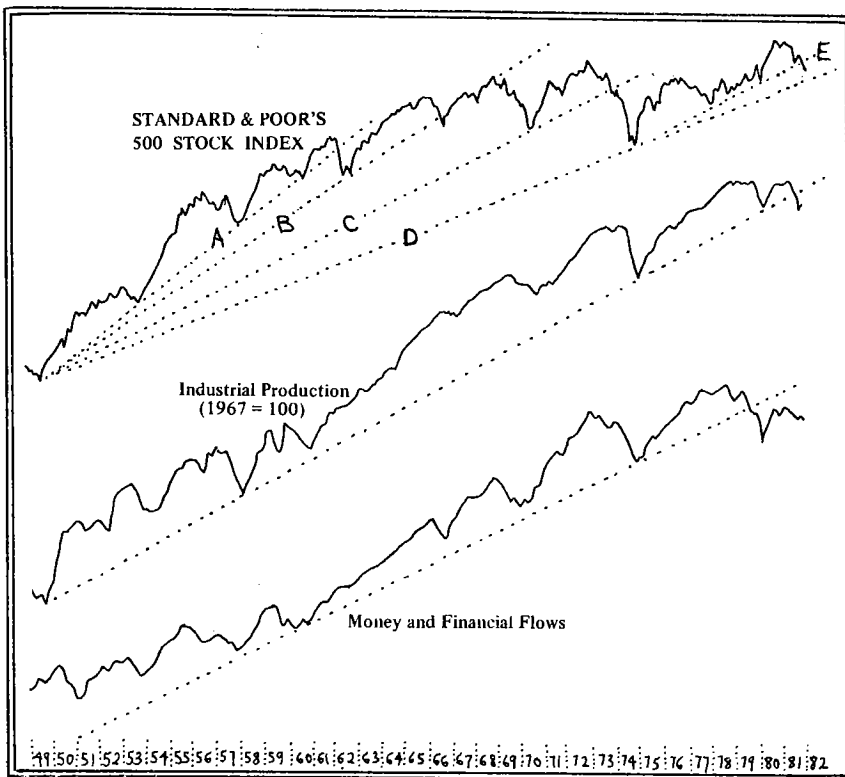
There are three long-term growth lines that are worth examining at this time. They are all illustrated on the ratio chart shown on page 5, a chart taking the items back to 1949 (1949 is when the great post-World War II growth began.)

The first item is the Standard & Poor's 500 Stock Index. I have drawn five rising trendlines, four of which begin at the 1949 bottom. Trendline A measures the steep growth rate of the 500 from 1949 to 1961. This growth rate ended in 1962 when trendline A was broken.

Trendline B measures the growth rate from 1949 to 1968. This growth rate was reversed when the trendline was shattered in 1962. Trendline C measures the shallower growth rate from 1949 to 1973. The 1973-74 crash ended the trendline C growth rate. Trendline D measures the still shallower growth rate from 1949 to 1980. This trendline is intact. I estimate that the S & P 500 would have to decline to 103 to decisively crack trendline D.

I have drawn trendline E, a seven-year trendline connecting the 1974 and 1980 bottoms. This trendline was cracked this year when the S & P 500 fell below 117. Conclusion: The S & P 500, a broad measure of market value, has lost its upward momentum, and three long-term growth lines have been broken. The S & P 500 Index is now selling below its 1973 peak, and it is just above the high recorded 13 years ago in 1968.

The next item on this chart is US Industrial Production as shown in the Dept. of Commerce BCD Digest. Here we see a 32-year rate of rise broken—during 1982. The trendline appears very valid, having been tested in 1949, 1958, 1975 and again in 1980.



The final item on this chart is what BCD terms Money & Financial Flows. This is made up of three items, M-2 money supply in 1972 dollars, change in total liquid assets and total funds raised by private nonfinancial borrowers in credit markets. As you can see, this item has held above its long-term trendline ever since the 1940's. I have drawn the trendline connecting the 1957, 1960 and 1974 bottoms. This trendline was reversed in 1979. During 1980 there was a rally in the money and financial flows, but now the flows have bearishly turned down again.

Thus, we have stocks, industrial production and money & financial flows cracking very long term rates-of-growth trendlines. I believe this action is ominous. I believe this chart is warning us that we have passed the point of no-return on deficit and debt. We are moving very close to the time where the piper must be paid.

MUSINGS: I'll be 58 years old this July 22. For some reason, I've received a number of letters over the last year asking me if I'm religious. The answer is, "Yes, in my own way, I most certainly believe there is a God." I got religion about 12 years ago when I started tabulating the number of times I've come near death. One, two, three times may be coincidence. But I've counted at least eight times when I've bumped into the black angel. It made me think, "There must be a reason why I'm still alive and kicking."

I nearly died of a mastoid infection at age eight. I was a bombardier with the Twelfth Air Force in Italy during World War II. Aside from many near-misses in combat, our B-25 got lost over the Sahara Desert (flying down the West Coast of Africa), and I list that as a very close call. I suffered a heart attack in 1971, but I'm in better health than ever today (thanks to no smoking and less weight). I had two rather hairy accidents on my motorcycles, one which cost me about 20% of my skin, and the other (when a truck overturned next to me) gained me at least 100 gray hairs. Enough!

Now I've calmed down. I don't smoke, I don't fly combat, I don't ride motorcycles (although I miss 'em), and I jog every morning from 4AM to 4:45. I eat almost no red meat, watch my weight, and am on my second litter of kids. I have five of them, from 1 year to 26 years, and I love them all. One (my 22 year old) is autistic, and she's never talked. I went through things with her that I'd hesitate to write about (but I learned more from that schizophrenic girl than you'd believe—about life, about humility, and about myself).

I've been held up at knife-point in Harlem, I've been blessed (even though I'm a Jew) by the Pope (Rome, 1945). I've been Rolfed, I've been through group therapy, Gestalt therapy, acupuncture, I've been in the Synanon "games."

I've lived like a motorcycle bum, and I've lived like a rich man. And I've come to a few conclusions. One is that ultimately every person must take responsibility for his or her own life. I totally agree with Carl Jung who wrote, "Your main duty on this earth is to find yourself—and live accordingly."

After 58 years of the kind of life I've led, you either get religion or develop some type of rational philosophy or you go under. I did numbers one and two, and I have no intention of doing the third.

I guess I could go on and on with this kind of nonsense, but now I want to tell you just a few things that I've learned. Here's number (1): There's a lot more to life than making money. Or let me put it another way: If your insides aren't right, it doesn't make much difference what the outside is like. The wise man said, "Man cannot live by bread alone." Jesus said, "What profiteth a man if he gains the whole world and loses his soul." You better believe it. Next, do you know the two hardest things in the world to do? You may disagree with me, but here are my two choices:

(2) To get real, honest, truthful, dependable information on any subject. I don't care if it's the right food to eat, how to treat an earache, or how to invest your money at any given time. I've always found it hard to get the facts, the dependable, correct information. Lord, it's hard. But it can be done!

(3) I've always found it difficult (at times impossible) to get people to **DO WHAT THEY SAY THEY ARE GOING TO DO**. People talk, they make promises, they "try" (everybody tries), but they usually don't deliver. If you have a friend or a broker or a doctor or a lawyer who delivers, who does what he says he's going to do—when he says he's going to do it, then treasure him (or her). Wine him, dine her, kiss their feet. They're rare, very rare.

NOTES & QUOTES: There is much talk about the huge underground economy of the US. Many wonder why it is thriving. But history shows that the more confiscatory a country's tax system, the bigger the growth in its underground economy. In Italy it is estimated that 25% of its GNP is via the underground. In America it is thought that the underground economy is well over 10% of the economy.

If you don't believe this, I suggest you go to any swap meet. Here in San Diego we have three monster swap meets every week with many smaller local meets. At the swap meets (which are actually giant discount sales) you can buy anything from a truck

tire to a motorcycle, from new tools to the latest FM-AM radio. All of it is sold with no tax added.

* * * *

What do you do when a Communist country can't pay it's debt? You cover your bum loan with a "sweetener." That's exactly what happened when 500 Western banks agreed to a "re-scheduling" of \$2.4 billion in interest that Poland couldn't pay in 1981. Now Poland will pay 1.75% above the London interbank rate, plus 1%.

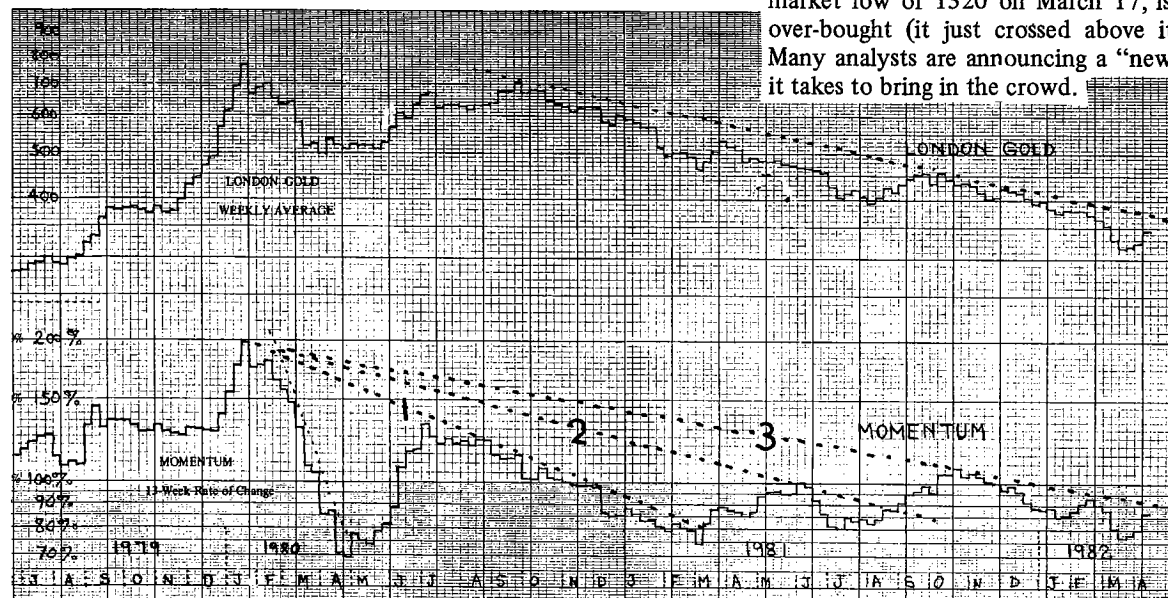
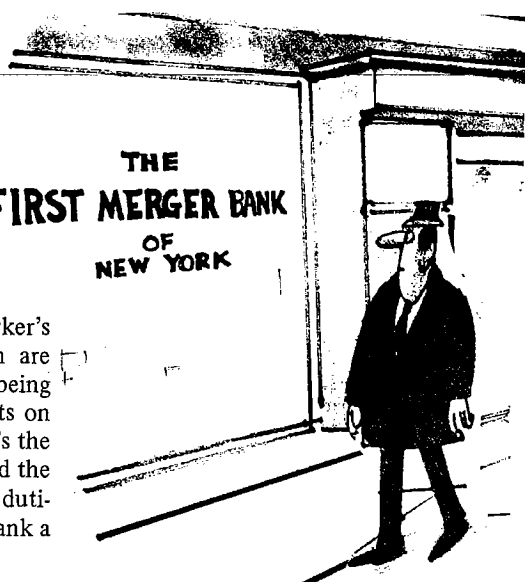
The pact was signed yesterday in Frankfurt by representatives of Poland and 13 Western banks. It will be circulated in coming weeks for the signatures of nearly 500 other creditor banks. The pact covers 95% of about \$2.4 billion that came due last year and reschedules the payments over 7½ years.

Under the rescheduling plan, Poland will pay a higher interest-rate margin than it would have if it had repaid the original loans last year. The new accord calls for interest to float at 1.75 percentage points above the London interbank offered rate, currently 15¼%. Poland will also pay a 1% rescheduling fee.

extra for re-scheduling. There that should hold them! Will Poland pay the new re-scheduled interest? Don't bet on it, but anything looks better than fat losses on the books of the banks.

THE FIRST MERGER BANK OF NEW YORK

In the New Yorker's world, little men are constantly being shocked by events on Wall Street. Here's the latest shocker, and the little fellow is dutifully giving the bank a "double take."



GOLD: All three gold items in the gold chart (see last Letter) broke out of their declining trendlines—to the upside. This makes me think that there is a better than 50/50 chance that gold has seen its final low. If not, there could be one more sell-off in taking the metal back to the 312.50 low— or perhaps a bit lower. But I feel that most of the damage has been done.

That does not mean that gold is going to immediately head skyward. Remember, there is a deflationary "feel" in the air (not good for gold) and interest rates remain high (making it expensive to hold gold).

"Then why has gold rallied?" you ask. Maybe in reaction to the Falkland Island crisis, but I doubt it. I think gold may have bottomed as a response to the continuing build-up of world debt. There is a certain percentage of informed money that wants to buy insurance against a potential "paper-money disaster." By that I mean that if debt continues to build, at some time some of this paper (and probably a lot of it) is going to be worthless. At that time, regardless of interest rates or deflation or anything else, there will be a major move into gold. Remember, gold isn't a promise to pay, gold isn't a managed piece of "legal tender." Gold is money, and it will still be money when the lire, the dollar, the mark and the franc are museum exhibits. That is the value of gold. And serious investors know it.

One study that I am watching carefully now is my gold momentum chart or 13-week rate-of-change for gold. As you can see, gold has broken above trendline 1 and 2. Trendline 3 would be reversed if gold can move up to and hold at the 375 level. Note also that on this ratio chart, gold (upper line) would have to rise above the 375 level in order to reverse its downtrend.

CONCLUSION: The 375 level is important for gold. If gold rallies above the 375 level and holds there, the odds will increasingly suggest that 312.50 was THE low. The 5-week moving average for gold is currently 346, so gold is above its 5-week MA for the first time this year. The 13-week MA stands at 353 and the all important 50-week (primary) MA is at 409. In about a month the 50-week MA will be down to 400. If gold can move above its 50-week MA, the picture will be increasingly impressive for gold, and at that time we may do some buying.

LATE NOTES: The market is now over-bought but the advance in the Dow has been sub-standard (the Dow is up only around 50 points in five weeks). The PTI, having hit a bear market low of 1320 on March 17, is now 53 points higher and over-bought (it just crossed above its 21-day moving average). Many analysts are announcing a "new bull market." That's what it takes to bring in the crowd.

NOTICE: The next Letter, scheduled for May 5, may be a day or so late and somewhat abbreviated. I'll be in New York City at the end of April—and will have to write on the run.